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SUBJECT: Economic update - Guatemala: January 3-23, 2006

Summary

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- 2. OVER \$300 MILLION FOR INFRASTRUCTURE PROJECTS
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1. GUATEMALA LAGS BEHIND REGION IN ECONOMIC GROWTH

(U) According to a Bear Stearns report, with a 3.2% economic growth rate and a 2.3% population growth rate, Guatemala remains in next to last place of CAFTA-DR countries for per capita GDP growth in 2005. The absence of judicial and fiscal certainty is cited as one of the principal impediments to growth, since it deters foreign investment. Analysts call for a growth rate approaching 7% for the country to address its many socio-economic problems. (Guatemala's population growth rate of 2.3% is the highest in the CAFTA-DR region, where the average is 1.7%, while yearly GDP growth of 3.2% is second lowest after El Salvador, and well below the CAFTA-DR average of 4.7%.)

2. OVER \$300 MILLION FOR INFRASTRUCTURE PROJECTS

(U) Communications and Infrastructure Minister Castillo announced that his ministry will invest \$301 million in five major project areas, including road, port and airport rehabilitation. The roads alone will see \$78.5 million in improvements, including repair of damage caused by Hurricane Stan. Road improvements include widening the road to the Pacific, finishing the beltway around Guatemala City, and constructing a northern corridor highway. The ministry announced \$65 million to develop new airports and renovate the capitol's international airport, La Aurora. The GOG hopes that these improvements will attract more foreign investment, particularly after CAFTA implementation.

3. TAX EVASION BILL SLOWLY MOVES THROUGH CONGRESS

(SBU) A bill on tax evasion that has been under discussion for months is stalled in the Congressional Finance Commission. Victor Ramirez, the Commission president, admits that there is still a lot of work to be done and plans to call extra sessions as needed. Passage of a tax bill is considered urgent, due to a shortfall in 2005 tax revenues. Guatemala has long struggled with tax collection and enforcement, with a huge informal sector that includes relatively large businesses. Currently, the tax to GDP ratio is a low 10.1%, far from the goal of 12% set by the 1996 Peace Accords. Legitimate taxpayers, which include the country's most powerful business groups, demand improved enforcement before new tax measures are passed. Business chambers publicly voice support for the bill; however, there are fears that behind the scenes they may undermine it, as they have with similar measures in the past.

4. INCREASED ACTIVITY AT GUATEMALAN PORTS

(U) Guatemala saw an overall 6.7% increase in port activity in 2005. The largest port, Puerto Quetzal, located on the Pacific coast, saw nearly a 20% increase. Authorities praised the teamwork demonstrated by port employees, and are eager to attract additional investment and shipping companies. Freight traffic has increased steadily since 2003, with 5.0% growth in 2004 and 5.8% in 2005. Proposed port improvements

and the implementation of CAFTA should bring further gains for
12006.

15. PNEUMONIA AND DIARRHEA TOP KILLERS

(U) According to a recent study, the principal cause of death in Guatemala is Pneumonia, with 7,168 fatal cases reported in 2005, followed by diarrhea, with 1,782. The leading cause of death in developed countries, heart attacks, ranked fourth, behind murders or injuries from armed assaults, for which Guatemala has one of the world's highest per capita rates. The lack of strict water sanitation, food safety and public health standards are chiefly to blame for the spread of diseases. The public health system, which is generally overcrowded and ill equipped, is hard pressed to handle the demand for care.

16. AVIAN FLU PREVENTION PLAN

(U) Guatemala is working with regional health agencies to establish a permanent commission for the prevention of Avian Flu. A February session of congress will be devoted to educating members and the public about the dangers and methods of preventing Avian Flu. There have been isolated reports of the less virulent strain of Avian Flu reported in the northwestern parts of the country along the border with Mexico. However, the infected chickens have been isolated and destroyed, and there has been no connection to the deadly form of the Avian Flu now threatening Asia and parts of Europe.

17. AUTOMOBILE SALES RISE DISPTIE LIMITED ECONOMIC GROWTH

In spite of only modest economic growth in 2005, car sales were reported as very strong. This increase was largely a reflection of a change in the assessment of taxes under GATT guidelines. Historically, Guatemala imposed a flat tax on the sale of cars. For used cars there was a blue book value that applied regardless of the actual cost of the car. Now, tax on the sale of cars is assessed based on the value of the sale. As a result, used car sales rose by almost 100%, while new car sales rose by only 2%. Skeptics wonder if under the new guidelines buyers are undervaluing the true cost of the transaction to avoid paying higher taxes.

18. 225,000 SCHOLARSHIPS WILL BE AWARDED FOR 2006

The Ministry of Education will issue 56,000 more educational scholarships this year for a total of 225,000. This increase in funding for education, which is being realized through assistance from UNICEF, will focus on assisting children in the primary school. A 2005 review of the educational system identified 2,300 schools where the likelihood of students dropping out was extremely high due to poverty. Analysts fear that most of the children taken out of school enter the child labor market. Under the scholarship program specific attention will be devoted to children affected by Hurricane Stan, whose families may be under particular financial pressure to take their children out of school in order to work.

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